

Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
125 East 93rd Street
New York City 28

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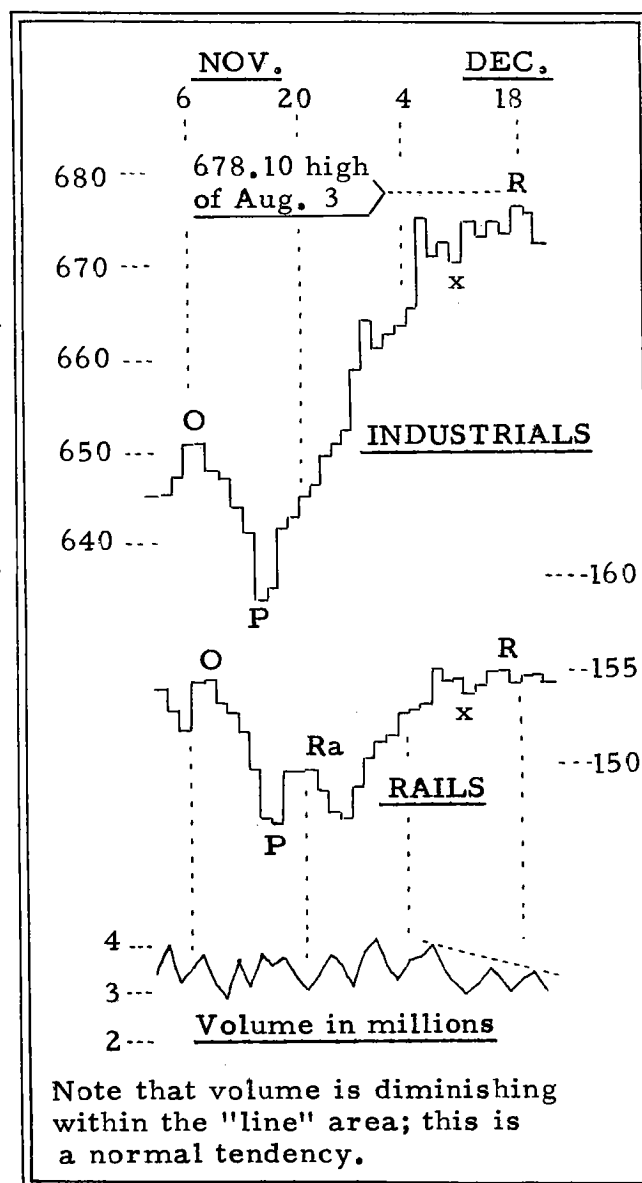
Number 88

Page 1

THE MARKET. I have been asked how, with the pent-up demand created by the steel strike, the consumer's insatiable appetite for borrowing and buying and the general high level of business activity, there can be anything but a booming stock market in 1960. Others have asked me how, in the face of a collapsing Government bond market; sagging farm prices and the pressure of high interest rates, the country can enter into a further and even greater boom. I must confess to both the bulls and the bears that I have never been able to scan the thousands of financial statistics, digest them, and then draw valid conclusions regarding the direction that the stock market must take. Profits I have shown have always come through an analysis of the movements of the Averages taken together with volume and other technical indications. The vision of the Averages (as a few hours of study at the public library will bear out) has consistently proved superior to that of the whole statistical fraternity lumped together. "The stock market barometer," wrote Hamilton, "does predict. It shows us what will happen to the general volume of business many months ahead. It even goes further and warns us of the danger of international events which could upset all ordinary calculations based on the course of business as inferred by the records. It cannot be too often repeated that the stock market barometer is acting upon all the knowledge available."

Following the Rail rally above point O (See Letter 86) the expected approach to the 678.10 Industrial high took place. I mentioned in Letter 87 that "lines" are frequently formed directly under critical points, and this is exactly what has occurred. For the benefit of new subscribers, a line is a structure lasting ten trading days or longer, during which time both Averages move within a range of about 5%. A line indicates a period of very evenly matched buying and selling, and it usually proves fruitless to speculate as to the direction of the final breakout. Simultaneous advances by both averages above the line limits imply higher prices while simultaneous declines below the line limits imply lower prices.

In the twelve days since December 8, Industrials have not been higher than 676.65 (R) nor lower than 670.50 (x), a range of less than 1%. During the same period Rails have fluctuated in a narrow area bordered by 154.99 (R) and 153.65 (x), a range of less than 1%. This is an extremely tight line structure, and a rally by both indicators



above the line highs (R) on increasing volume would imply a bettering of the 678.10 Industrial bull market high and a new upward leg on the advance. Conversely, a violation of the lower line limits (x) on increasing volume would suggest weakness in the price structure and generally lower market levels.

In the event of an upside line breakout which takes Industrials through the August bull market high (678.10), there is nothing in the Dow Theory that can tell us how far the move will carry. It should be noted that a new Industrial high at this juncture would lack real authority because (1) it would not be confirmed (except in a minor sense) by the Rails, and (2) the validity of successive primary penetrations in an aging bull market grows progressively weaker (eventually there will be a final penetration which will be the last one prior to the top).

Because late December is "rally-time", a refusal by Industrials to better their 678.10 high between now and the end of the year would cause concern. We would hear talk of a possible "double top", and additional bearishness would arise since traders do not like a market that hesitates in the face of a "bullish press". In other words, if January arrives and the market is still hesitant, it would not be surprising to see traders swapping stocks for cash.

1960. The stock market crystal ball is seldom spotlessly clear. It was as clear as it will ever be in early 1958 when the pattern of the Averages was extremely bullish, the short interest ratio was sky-high, the professionals were skeptical and the odd-lotters (the public) were actually selling more than they were buying. That we will not again see such a barrage of excellent technical indicators in this bull market is almost certain.

Referring to year end market appraisals, Hamilton wrote that the "reviews are always better than the forecasts". Or, as the economist Eliot Janeway recently put it, the disease of the market forecaster, which seems comparable to the common cold, is "amnesia".

Many of the same people who were bearish during the "bargain levels" of 1957-58 are rampantly bullish today. I have before me the year end forecast of one of the nation's largest investment services. They write, "New highs are again indicated for the economy in 1960." This, they add, "will mark an appropriate beginning for a 'golden decade' holding promise of exceptional further expansion." This is certainly a rosy prediction, yet it is typical of what is being said in the majority of newspapers, magazines and services these days. Could this service be correct? Of course they could, but a study of their predictions just before important turns in the past suggests that we retain a healthy skepticism. "When everybody is bearish", runs the old adage, "they are usually wrong. When everybody is bullish, they are sometimes right for a while."

THE STOCK MARKET AND MAJORITY OPINION. Hamilton said that he had never known the majority of professional opinion to be correct. The brilliant Richard Schabacker went into this problem in more detail when he wrote, "Suspect any trend analysis which seems too widely held in the public's mind, and utilize the theory of crossing operations whenever the composite of professional and popular anticipation is overwhelmingly inclined on one side of the market only, to the practical exclusion of the other side."

Schabacker then notes one important exception to this attitude: "This is when the services and reputable advisers have been consistently wrong in their forecasts for a tedious interval. In such cases they are likely to be correct -- at just about the time that the public, and perhaps even the services themselves, have lost patience and faith in their proper analysis. The best illustration of this situation was in 1929. Able forecasters had been bearish for over a year. They had been wrong for so long that no one heeded or respected their bearish warnings. In such circumstances the bearish view was logical, for it was still the 'unpopular' view." ("Stock Market Profits", Schabacker, 1934).

It has always seemed to me that the premature bears of 1928-29 were defeated by Newton's second law -- momentum. The stock market, like all matter, is affected by certain physical laws, and the momentum created by a bull market usually carries further than anyone expects. One reason for this is that towards the end of a bull market (particularly an extended one) stocks are bought for no reason other than they are going up. In simpler terms, once the ball starts rolling it tends to continue rolling and is not easily stopped.

To sum up the situation, although we cannot discount the possibility of a final speculative "binge", we should also remember that when the prestige of today's bears hits its lowest ebb, it is then that they will be closest to being right. This is what happened in 1929; it will happen again.

TREASURY BILLS. The yield on Treasury bills has been hitting record highs week after week. At present the 91 day bills provide a 4.6% yield while the 182 day bills yield about 4.9%. These bills may be purchased through the banks or through brokerage houses at very low commissions, and they are a fine medium in which to place stock market profits.

NOTE: The short interest ratio for the latest period has dropped to .89, the lowest point since March, 1956. As explained in the last Letter, anything under 1.0 renders the market vulnerable while a level of about .5 is distinctly bearish.

Subscribers may be interested in the article which I have written for Barron's on the short interest ratio; it is scheduled to appear in the new issue on the newstands Monday, December 28th.

In closing I would like to wish all my subscribers a most happy, healthful and prosperous New Year.

(Written December 23rd at mid-day)

Thirty Stocks Used in Dow Jones Industrial Averages are:

Allied Chemical	General Electric	Sears Roebuck
Aluminum Co.	General Foods	Std Oil of Cal.
Amer Can	General Motors	St Oil of N. J.
Amer Tel & Tel	Goodyear	Swift & Co.
Am Tobacco	Inter Harvester	Texaco Inc.
Anaconda Co.	Inter Nickel	Union Carbide
Bethlehem Steel	Inter Paper	United Aircraft
Chrysler	Johns Manville	U. S. Steel
Du Pont	Owens-Ill. Glass	Westinghouse El
Eastman Kodak	Procter & Gamble	Woolworth
Twenty Railroad Stocks Used are:		
Atchison	Erie	NY NH & H
Atl Coast Line	Great North Ry	Norfolk & West'n
Baltimore & Ohio	Illinois Central	Pennsylvania
Canadian Pacific	Kansas City So	Southern Pacific
Ches & Ohio	Louisv & Nash	Southern Railway
Chi Rk Is & Pac	N. Y. Central	Union Pacific